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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

TRUNKLINE GAS COMPANY

and

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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REPLY BRIEF OF PETITIONERS TRUNKLINE GAS COMPANY AND PANHANDLE EASTERN PIPE LINE COMPANY

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TABLE OF AUTHORITIES

Cases Page

Board of Trade of Chicago v. United States, 246 U.S. 231 (1918) 4

Public Service Commission v. FPC, 437 F.2d 1234 (4th Cir. 1971) 6

Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board, 106 S. Ct. 709 (1986) 5, 6

United Gas Pipe Line Co. v. FERC, 597 F.2d 581 (5th Cir. 1979), *cert. denied*, 445 U.S. 916 (1980) 5

United States v. El Paso Natural Gas Co., 376 U.S. 651 (1964) 4, 5, 6

Regulatory Order

Transwestern Pipeline Co., 32 FERC (CCH) ¶ 61,009 (1985) 5

Statutory and Regulatory Provisions

Natural Gas Act,

15 U.S.C. §§ 717-717w (1982) ..... *passim*

Natural Gas Policy Act of 1978,

15 U.S.C. §§ 3301-3432 (1982) ..... *passim*

18 C.F.R. § 2.61(c) (1985) 6

Congressional Materials

H.R. Rep. No. 1290, 77th Cong., 1st Sess. (1941) 6

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Trunkline Gas Company (Trunkline) and Panhandle Eastern Pipe Line Company (Panhandle) hereby submit their reply brief in the above-captioned action.

The Brief for the Federal Energy Regulatory Commission (Commission) in Opposition to Trunkline's and

Panhandle's petition for certiorari (hereinafter cited as "Commission Brief"), combining its response to the petitions for certiorari of several pipeline companies, seeks to defend the orders of the Commission below on grounds that they were a simple "policy determination" (*e.g.*, Commission Brief at 18) and that the Court of Appeals correctly held that "substantial evidence supports the Commission's decision to bar recovery of variable costs through minimum bills." *Id.* In support, respondents offer three "essential findings"—actually only two separate factual conclusions [1]—which, they allege, were supported by substantial evidence. *Id.* at 11-12. Because the Court of Appeals has held that such substantial evidence existed in the record, they assert, this Court should not intercede by grant of certiorari. *Id.* at 18.

But contrary to respondents' assertions, Trunkline's and Panhandle's petition was not merely a disagreement as to the factual findings and policy determinations of the Commission. Instead, it was based on the insufficiency of the factual findings, supported or not, to overcome the central illegality of the Commission's action under the Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432. The "essential findings" relied on in the analyses of the Court of Appeals and the Commission do not ameliorate this illegality, they aggravate it.

First, the Commission Brief once again (at 11-12) revives the assertion that the elimination of variable costs from pipeline minimum commodity bills would operate to prevent windfall recoveries by pipelines of variable costs, including purchased gas costs, for gas which

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[1] The third "essential finding," cited by the Court of Appeals and the Commission Brief, is merely duplicative, asserting only that the purported negative impact of the first two "essential findings" outweighs any benefits that could accrue from retaining minimum bills. Commission Brief at 11-12.

their customers do not take. Because of the continued repetition of and reliance on this point, it becomes necessary to emphasize, as we have done at all levels, that there is no record evidence whatever that any of the contract or tariff provisions ever operated to produce that result, or that a penny of such "windfall" has ever been pocketed by any pipeline. The argument is a straw man because the partial requirements customers have always taken at least their minimum bill levels and they do not pay for gas not taken.[2] This fact is not surprising. It reflects only that minimum bills have worked as they are intended to—to contractually commit pipelines' customers to purchase specified minimum amounts of gas for the long-term.

The Commission and its supporters, however, attempt to turn this virtue into a vice. They seek to avoid the obvious fact that if the volumetric level of the customer's obligation is too high, that level may be reduced in appropriate Commission proceedings. The NGA, in Sections 5 and 7 (15 U.S.C. §§ 717d, 717f), provides specific procedures for effecting such a reduction in quantity. These procedures reduce both the obligation of the pipeline to provide the gas and the obligation of the customer to receive or pay for a percentage of the certificated volumes. The statutory scheme makes these obligations *mutual*, not unilateral as the Commission has ordered. It is

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[2] Neither the Commission nor the Court of Appeals cited any record evidence of the permanent collection by a pipeline of amounts representing costs not incurred. (In the sole reference by the Commission on this issue, it cited only an instance in which such costs had been collected *and later refunded*; *see* Pet. App. at A-183.) Instead, as admitted in the Commission's Brief at 12, both the Commission and the Court of Appeals simply held that it *did not matter* whether such costs were ever recovered in fact so long as the "potential" for such recovery existed. *See, e.g.*, Pet. App. at A-33. But so long as minimum bills work as intended—to set minimum purchase commitments for pipeline customers—no such potential for overrecovery actually exists.

neither necessary nor appropriate under this statutory scheme to eliminate the payment obligation of the customer while maintaining the pipeline's supply obligation.

In the second of the "essential findings" cited in the Commission Brief (at 12), the Commission asserted that by successfully requiring a pipeline's customers to take a minimum amount of gas, minimum bill clauses are "anti-competitive" because they prevent customers from purchasing that same gas from the pipeline's competitors. This simple truism, however, provides no support for the Commission's action. The Commission's characterization of these long-standing contract provisions as "anticompetitive" is patently illogical, because it applies with equal force to any purchase contract whatever. As this Court has so pertinently stated:

> [T]he legality of an agreement or regulation cannot be determined by so simple a test, as whether it restrains competition. Every agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence.

Board of Trade of Chicago v. United States, 246 U.S. 231, 238 (1918).[3] The Commission's analysis, based as it is on these two "essential findings," is therefore arbitrary on its face.

More fundamentally still, the Commission's reasoning is fatally inconsistent with the structure of the natural gas pipeline industry established in the Natural Gas Act and fortified by years of agency and court precedent. As this Court stated definitively in *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964), the pipeline industry is sustainable *only* by the establishment of long-term contracts between pipelines and their custom-

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[3] Indeed, minimum commodity bills restrain competition *less* than typical purchase contracts, since they only commit customers to purchase a specified percentage (*e.g.* 75 percent) of their contract quantities of gas.

ers, which make possible the massive investments required to construct pipelines and establish service. The NGA recognizes this structure by requiring certification of core market sales contracts, thereby removing them from the competitive arena. *Id.* Forcing pipelines to engage in day-to-day competition to retain their core sales markets is inconsistent with this NGA-mandated industry structure. *Id.* The Commission may not, therefore, impose mandatory, day-to-day competition for core markets; its competitive concerns are to be directed toward maintaining the opportunity for competition for uncommitted or incremental sales in expanding markets, as discussed in the *El Paso* case. *Id.*

It is no answer, as the Commission Brief suggests (at 16), that the Commission still permits the recovery of fixed costs in minimum bills, thus covering the cost of pipeline facilities themselves.[4] Huge investments are equally necessary—in the form of take-or-pay and other contractual commitments—for pipelines to establish the long-term supply sources which are vital to their ability to satisfy their own utility obligations, to which they remain committed even though the Commission is releasing the customer from the obligation to purchase. *See, e.g., Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board,* 106 S. Ct. 709, 712 (1986); *United Gas Pipe Line Co. v. FERC,* 597 F.2d 531, 588 (5th Cir. 1979), *cert. denied,* 445 U.S. 916 (1980).[5] The fostering

[4] Even this rationale is no longer factually supported. In a recent rate case involving Transwestern Pipeline Co. the Commission rejected even a fixed-cost minimum bill, replacing it with a rate design which *denied* assurance of recovery of large portions of fixed costs, including any return on the equity investments made in pipeline facilities. *See Transwestern Pipeline Co.,* 32 FERC (CCH) ¶ 61,009 at 61,031-32 (1985).

[5] The Commission (and its predecessor Federal Power Commission) has long required, for example, that pipelines seeking authorization to construct major new facilities or provide a new

of such stable long-term supply relationships is a keystone of regulation under both the NGA and the NGPA—for the fundamental goal of both is to "assure *adequate supplies* of gas at reasonable prices." *Transcontinental Gas Pipe Line Corp.*, 106 S. Ct. at 716 (emphasis added). Plainly, in order to permit the obtaining of such supplies, pipelines must be able to receive commitments from customers to purchase minimum amounts of the gas obtained—and this is precisely what variable-cost minimum commodity bills accomplish.

Eviscerating pipelines' sales contracts, by effectively removing the customers' obligations to purchase, is an attempt to comprehensively restructure the supply relationships of the industry, in a manner which is not permitted by the NGA or the NGPA. Moreover, the Commission embarks on such restructuring in the name of promoting competition for pipelines' *core* markets, forcing pipelines into "a continuous daily struggle to hold old customers and to win new ones over from their rivals"—a type of competition which this Court has specifically recognized to be beyond the purview of the NGA. *El Paso Natural Gas Co.*, 376 U.S. at 659-60. The Commission has no authority—under Section 5 of the NGA (15 U.S.C. § 717d), Section 7 of the NGA (15 U.S.C. § 717f) or any other statutory provision—to adopt a rule so directly at odds with the market structure established by its governing statute.

Neither the Commission nor the Court of Appeals has begun to address, much less to rectify, this fundamental

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service must make a showing that adequate gas supplies are under contract to support the facilities' construction or the service's offering. *See, e.g., Public Service Commission v. FPC*, 437 F.2d 1234, 1237 (4th Cir. 1971); 18 C.F.R. § 2.61(c) (1985). Indeed, Congress expressly contemplated such a requirement. *See* H.R. Rep. No. 1290, 77th Cong., 1st Sess. 2-3 (1941).

invalidity of the orders under the NGA and NGPA. This basic defect, and the massive rearrangement of the entire gas pipeline industry which results, plainly justify the grant of certiorari in this case.

Respectfully submitted,

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